This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 KINGSTON 001406

SIPDIS

STATE FOR WHA/CAR/ (WBENT), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR L LAMONICA

E.O. 12958: NA
TAGS: ECON EFIN JM
SUBJECT: JAMAICAN ECONOMIC GROWTH REMAINS SLUGGISH

Ref: KINGSTON 1319

¶1. Summary: Data published by the Planning Institute of Jamaica (PIOJ) in May 2005 showed that the economy continued to suffer from the residual effects of Hurricane Ivan as well as prolonged drought conditions. The unfavorable weather conditions stymied agricultural production, fueling an increase in prices. The GOJ's fiscal balance, while positive, also fell below expectations. However, the Bank of Jamaica continued to maintain order in the foreign exchange market. Economic performance is expected to recover during the second quarter, with the PIOJ forecasting increased GDP growth on the back of robust tourism, construction and electricity production. Inflationary pressures are expected to emanate from higher food prices and the new tax package, but the increased taxes should help the GOJ to achieve its fiscal target. The foreign exchange market should remain stable given the recent jump in the stock of Net International Reserves (NIR). End Summary.

¶2. Data published by the PIOJ in May showed that the Jamaican economy has started to recover from the effects of Hurricane Ivan, with real GDP growing by 0.6 percent during the quarter ending March 2005. However, this was lower than the one percent projected for the quarter, reflecting the residual impacts of the hurricane and the prolonged drought that led to an outbreak of bush fires (reftel). These conditions combined to put a damper on agriculture, resulting in a 23.8 percent drop in production compared to the previous year. All other areas of the economy registered growth during the period. In the goods-producing sector, construction output jumped by 5.5 percent as the sector continued to benefit from post-Ivan rehabilitation activities. Although the petroleum refinery remained closed, GDP in manufacturing rose by 2.1 percent, reflecting buoyant cement production and higher beverage output. Growth of two percent in the services sector was primarily the result of a 2.9 percent rise in transport and communications and a 6.5 percent jump in miscellaneous services (including tourism).

¶3. GOJ operations generated a fiscal surplus of USD 43.3 million during the quarter. While this was the only surplus recorded for the fiscal year, it was USD 75 million less than programmed. The lower surplus arose from higher than budgeted expenditures of USD 70 million and a USD 5 million revenue shortfall. Higher program and wage costs, along with new capital projects, were the major contributors to the spike in expenditures. The surge in recurrent programs and capital projects was offset by reduced interest payments, reflecting the consistent decline in interest rates. Inflation also deviated from expectations during the period. Prices actually moderated during the first two months of the quarter, but a one percent jump in March pushed prices for the quarter up to 1.4 percent. Inflationary pressures emanated from the drop in agricultural output, which fueled an increase in domestic food, meat and poultry prices. Increases in the cost of fuels and household supplies also contributed to inflation.

¶4. While most areas of macroeconomic management were challenging, the foreign exchange market remained stable during the review quarter. The nominal exchange rate depreciated by 0.3 percent, a one percent appreciation in real terms. The favorable conditions were underpinned by strong foreign exchange inflows from tourism, mining, remittances and goods exports. The BOJ also reported that growing investor confidence resulted in higher net capital inflows, as demonstrated by the increased sale of foreign exchange by commercial banks to the bank. The buoyant flows led to a further build-up in the Net International Reserves (NIR), which stood at USD 1.9 billion or 17.2 weeks of goods and services imports at the end of March
¶2005. This allowed the bank to reduce interest rates on two occasions in the quarter, resulting in the lowest rates since August 2002. The bank also reduced the special deposit requirement for deposit taking institutions from five to three percent.

¶5. Comment: The PIOJ is forecasting growth of 1.6 percent during the June quarter of 2005. This growth forecast is predicated on expanded output in construction, tourism, transport and communications. The GOJ should also meet its fiscal targets for the first quarter of 2005/06, now that most reconstruction related expenses are out of the way. Revenue collection has also returned to normal levels. This, combined with increased tax collection, should provide a boost to revenues. However, the new revenue measures will provide some impetus for inflation in upcoming months. With the onset of the rainy season, drought conditions have given way to flooding and landslides in agricultural areas, leading to further increases in domestic food prices. Volatile oil prices will also fuel further inflation and inflationary expectations.

¶6. Comment (cont'd): The BOJ expects foreign exchange flows to remain buoyant for 2005. The bank has, therefore, announced its intention to purchase excess supplies in order to smooth conditions in the market; ensure a stable and orderly system of payments in the medium term; and protect the economy from shocks. This policy is already being executed, and the stock of NIR has increased by USD 108.8 million in April to reach USD two billion, the highest amount in over a decade. If the economic fundamentals and investor confidence continue to improve, the bank could reduce interest rates even further in upcoming months. This could start a virtuous cycle in which declining interest costs will impact the fiscal balance and eventually result in an improvement of the country's credit ratings. End Comment.

ROBINSON